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December 12, 2005

**AGENDA ITEM: 9b**

**TO: MEMBERS OF THE INVESTMENT COMMITTEE**

- I. SUBJECT:** Update on Investments in Companies Doing Business in Sudan
- II. PROGRAM:** Global Equity
- III. RECOMMENDATION:** Information Only
- IV. ANALYSIS:**

**Executive Summary**

CalPERS staff has undertaken a multifaceted approach to identify and engage portfolio companies doing business in Sudan. The steps taken over the course of the last twelve months are outlined in this Agenda Item. Over the past three months staff has met with the five companies (four in person, one via telephone) identified as doing business in Sudan in the September 19, 2005 Agenda Item (Attachment 1). While the engagement process is ongoing, staff has not identified evidence to date in support of a conclusion that any of these portfolio companies (or their related business activities) involves parties supporting genocide or human suffering going on in Sudan.

As part of its ongoing effort, staff proposes to continue to:

- Engage portfolio companies that are reported to have business activities that support genocide and human suffering in Sudan;
- Engage Federal authorities that can provide guidance in this area; and
- Seek new and reliable sources for identifying companies engaged in non-humanitarian activities in Sudan.

Staff expects to report back to the Committee on these efforts in three to six months.

### **Background**

Over the last several years, ethnic and racial tension in the Sudan has escalated to the level the United Nations and the U.S. Department of State characterize as “genocide.” In recent months, it has been suggested that companies that do business in Sudan may thereby be furthering or condoning the nation’s support for terrorism or the egregious human rights violations occurring in that country. A company associated with the atrocities taking place in Sudan poses a serious risk to creating sustainable and responsible long-term value. Any such company runs myriad risks including but not limited to federal and international sanctions, substantial fines and penalties imposed by authorities, an impairment of their ability to raise capital in public markets as well as long term reputational damage.

At the September 2005 Investment Committee meeting, staff presented actions it has taken to date regarding such atrocities in Sudan which include:

- Build a coalition with four other public pension plans to establish an engagement process with companies doing business in Sudan.
- Engage through its coalition and by direct communication from CalPERS, the five companies identified as doing business in Sudan. These companies and a report of our engagement to date with them are included in this agenda item.
- Build a second coalition of 50 pension funds to engage the U.S. Department of Commerce, U.S. Department of State, U.S. Department of the Treasury, and the U.S. Securities and Exchange Commission.
- Engage 46 external investment managers and 1,869 portfolio companies in an effort to identify companies that may be operating in Sudan.

In addition to reporting the steps taken to date, staff also proposed a five step process to ensure that companies in which CalPERS has ownership positions are not engaged in any business activities that support genocide and human suffering in Sudan. The specific steps proposed by staff were:

1. Continue efforts at the federal level, such as Office of Foreign Asset Control (OFAC), to identify companies in which CalPERS has holdings and that have business operations in Sudan in order to make prudent investment decisions.
2. Submit letters of inquiry to companies against which OFAC has levied penalties for violating federal sanction programs specific to activities in Sudan. Our letter of inquiry will focus on what measures, if any, a penalized

- company has taken to prevent business activities from being performed in Sudan other than what is permitted under the OFAC sanctions program.
3. Work jointly with a coalition of institutional investors in an effort to appropriately identify, engage, and consider all investment options in companies that condone or support terrorism or the egregious human rights violations currently in Sudan.
  4. Engage companies directly associated with doing business in Sudan to ensure that those companies in which CalPERS is an investor are not engaged in business activities that support genocide in Sudan.
  5. Report to the Investment Committee on companies identified by staff as contributing in any way to the perpetuation of genocide and human suffering in Sudan.

The Investment Committee directed staff to implement the plan as outlined above including the possible use of a consultant to assist in refining a list of pertinent companies for engagement and report back on a periodic basis. This agenda item represents the first periodic report and update to the Investment Committee on staff's actions since the September 2005 meeting.

### **Company Engagement**

As reported at the September 19, 2005 Investment Committee meeting, Staff has identified five portfolio companies doing business in Sudan. Staff met with four of the five companies and participated in a conference call with the fifth between October and December 2005 to understand their business strategy and operations in Sudan. In addition, staff attempted to ascertain whether the portfolio companies engage in business activities with parties that support genocide in Sudan. Summaries of these meetings are included in Attachments 2 through 6.

While discovery efforts are ongoing and staff continues to pursue new sources that are "primary" in nature as opposed to "secondary" sources, staff is unable to confirm that the five portfolio companies originally identified are engaged in business activities that support genocide and human suffering in Sudan. In fact staff has not uncovered any evidence in support of the conclusion of wrongdoing on the part of these companies. Staff continues to pursue sources to substantiate the arguments made by the five portfolio companies that in fact they are operating in a manner sensitive to the welfare of the local people and culture.

The following five meetings took place with meeting notes attached:

- ABB Ltd.: October 13, 2005, Mark Anson, Christy Wood, and Coalition (Attachment 2)
- Royal Dutch Shell: November 17, 2005, Dennis Johnson (Attachment 3)

- Alcatel: November 21, 2005, Mark Anson (Attachment 4)
- Total: November 23, 2005, Christy Wood (Attachment 5)
- Siemens: December 5, 2005 – Conference Call, Dennis Johnson (Attachment 6)

### **Federal Engagement**

Efforts at the federal level continue to be pursued. On November 8, 2005, staff wrote to the U.S. Department of the Treasury and the U.S. Securities and Exchange Commission (Attachment 7), two agencies that did not respond to the initial letter from the 50 member coalition. In the letter, we reiterated the importance of their assistance in identifying companies operating in Sudan as well as requested a response from each entity.

In addition, staff is continuing to work with government and public affairs consultants, CalPERS' federal representatives in Washington, D.C., the Council of Institutional Investors, and the National Association of State Retirement Administrators. These resources and relationships are being utilized to obtain staff level meetings with the U.S. State Department and U.S. Treasury Department to urge federal involvement and guidance on companies operating in Sudan.

### **Monitoring the Office of Foreign Asset Control (OFAC)**

Staff continues to monitor the U.S. Department of the Treasury's OFAC for companies against whom OFAC has levied penalties for violating federal sanction programs specific to activities in Sudan. Since September 2005, OFAC has not levied any penalties against any of CalPERS' portfolio companies for violations of the federal sanction program for Sudan.

### **Third Party Consultants**

Several third party resources (ISS, KLD, and BGI) have been researched and explored to identify the appropriate companies doing business in Sudan. For a range of reasons, none of these resources has proved satisfactory.

However, CalPERS' relationship with Oxford Analytica has proven to be very constructive and detailed. Their conclusion is that each foreign company doing business in Sudan needs to be considered on a case-by-case basis. Staff continues to look for a consultant or third party resource to assist in refining the list of pertinent companies for engagement.

### **Update – University of California’s Board of Regents**

Last month, the University of California’s Board of Regents (“Regents”) unanimously voted to direct University staff<sup>1</sup>, to provide background analysis and recommendations for a comprehensive plan (“Sudan Strategy”) to divest from foreign companies engaged in significant business relations with the government of Sudan, principally PetroChina, Sinopec, Tatnef, and ABB Ltd. The Regents further requested recommendations about a general policy for when the University will consider future divestment under the Sudan Strategy. An up or down vote on the Sudan Strategy by the 26-member Board of Regents is expected at their January 18-19, 2006 board meeting.

### **Conclusion and Next Steps**

Staff has made considerable progress in implementing the plan outlined by the Committee. Staff has pursued meetings and contacts at the Federal level and there have been no additional companies identified by OFAC. Staff has engaged the five companies listed in the September 2005 agenda item and finds no evidence of these companies perpetuating, contributing to, or participating in business activities that support genocide and human suffering in Sudan. Lastly, third party products available in the marketplace on this topic have proved to be unsatisfactory.

As part of its ongoing effort, staff proposes to continue to:

- Engage portfolio companies that are reported to be engaged in business activities that support genocide and human suffering in Sudan;
- Engage Federal authorities that can provide guidance in this area; and
- Seek new and reliable sources for identifying companies engaged in non-humanitarian activities in Sudan.

Staff expects to report back to the Committee on continued efforts in three to six months.

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<sup>1</sup> University staff is being led by the UC Sudan Divestment Taskforce, a group of students pushing for the University of California Board of Regents to divest from certain companies doing business in Sudan.

**V. STRATEGIC PLAN:**

This item is not a product of either the 2005-2006 Strategic or Annual Plans.

**VI. RESULTS/COSTS:**

Over the course of last year, the primary cost to the Fund for this initiative has been significant staff time.

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Interim Chief Investment Officer

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Mark Anson  
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